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In the Supreme Court of the United States

OCTOBER TERM, 1936

No. 257

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

THE MIDLAND MUTUAL LIFE INSURANCE COMPANY

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT

BRIEF FOR THE PETITIONER

OPINIONS BELOW

The memorandum opinion of the Board of Tax Appeals (R. 8–11), is unreported. The opinion of the Circuit Court of Appeals (R. 18–22) is reported in 83 F. (2d) 629.

JURISDICTION

The decree of the Circuit Court of Appeals was entered May 6, 1936. (R. 18.) The petition for writ of certiorari was filed August 4, 1936, and was granted October 12, 1936. (R. 22.) The

jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether accrued interest on loans secured by mortgages constitutes taxable income to the mortgagee when the mortgagee acquires title to the mortgaged properties upon foreclosure by bidding them in at the foreclosure sales for an amount equal to the loans and accrued interest.

STATUTES AND REGULATIONS INVOLVED

The pertinent statutes and regulations involved will be found in the Appendix, *infra*, pp. 21–23.

STATEMENT

The stipulation of facts (R. 12–14) was adopted by the Board of Tax Appeals as its findings of fact (R. 8–11) and is as follows:

The respondent is an Ohio corporation and has its principal place of business at Columbus, Ohio. During the year 1930 there was due the respondent upon loans secured by real estate mortgages in Michigan and Ohio, interest in the amount of $5,456.99. As these loans were in default in that year, the respondent foreclosed its mortgages and at the foreclosure sales bid in the various pieces of real estate for amounts equaling the principal of the loans, plus the interest thereon.

Upon receipt of the title to such properties, the respondent transferred the investments on its

books from the mortgage-loan account to the real estate account and carried such assets at amounts equaling the principal of the loans plus any disbursements which it had made for taxes, court costs, attorney fees or insurance premiums for the preservation of the properties, but the amounts of interest included in the bid at the foreclosure sales were not entered upon the books as a part of the cost of the properties or as an asset of the respondent. Nor did the respondent include such interest as an asset in its annual statement or convention report for the year 1930. Its books have been kept on a calendar year, cash basis.

The instructions issued to the respondent's representatives who have charge of the foreclosure of mortgages, in States where a period of redemption is allowed, are to bid at the sale under such foreclosure proceedings in behalf of the respondent such sum as will enable the respondent to realize no loss on account of its investment in case a redemption should be made from the foreclosure sale. Bids by the respondent's representatives were made in accordance with these instructions, and the States in which the real estate here involved is located have laws allowing a period for redemption. The bids in respect of this real estate were made without regard to the actual value of the property, and the respondent was the only bidder at the foreclosure sales.

The properties which were acquired in these foreclosure proceedings, with the dates thereof and the

amounts bid by the respondent, are as follows (R. 10):

Location	Petitioner's Mortgage Loan Number and Name of Mortgages	Date of Bid	Date of Acquisition of Title	Amount of Bid
Detroit, Mich.	931—Caruso	Jan. 15, 1929	Jan. 15, 1930	$10,192.08
" "	1350—Ransom	July 22, 1929	July 22, 1930	16,525.88
" "	1326—Hallam	Aug. 6, 1929	Aug. 6, 1930	18,127.03
" "	1170—Harrington	Oct. 19, 1929	Oct. 19, 1930	39,251.57
Canton, Ohio	1093—Smith about	Mch. 19, 1930	Mch. 24, 1930	10,351.65
Lima, Ohio	623—Dalk "	Nov. 29, 1930	Dec. 2, 1930	33,334.00

The Commissioner determined that the sum of $5,456.99, representing accrued interest, was taxable income to the respondent and should be included in its return for the year 1930. The Board approved this determination. (R. 11.)

Before the Board, the respondent introduced the testimony of one witness who gave his opinion of the fair market value of the several pieces of real estate involved herein both at the time of foreclosure and the date of acquisition of title by the respondent. With respect to each property the amount testified to as of the different dates was less than the bid of the respondent. (R. 14–18.)

Conceiving it to be immaterial, the Board made no finding of fair value with respect to the foreclosed properties except to say that the fair market values were less than the amount of the loans upon such properties, plus accrued interest. (R. 11.) The Circuit Court of Appeals reversed the Board's decision and remanded the case for further proceedings consistent with its opinion. (R. 18–19.)

SPECIFICATION OF ERRORS TO BE URGED

1. The Circuit Court of Appeals erred in holding that the respondent did not realize taxable income in an amount equal to the accrued interest on certain loans which it held and which were secured by mortgages, when it bid in the mortgaged properties at the foreclosure sales for an amount equal to the loans and accrued interest.

2. The Circuit Court of Appeals erred in reversing the decision of the Board.

SUMMARY OF ARGUMENT

When mortgaged property is sold on foreclosure for an amount sufficient to pay the mortgage debt with accrued interest, the mortgagee has received payment in full of its debt, and that is so, regardless of whether the highest bidder at the sale is the mortgagee or a stranger.

In the instant case the respondent life insurance company bid in mortgaged properties, at public sales, for the full amount of the unpaid principal and accrued interest. It thus acquired the properties as a purchaser and established their values in sums equivalent to the unpaid principal and interest due thereon. The interest included in the value of the property, received and applied in the extinguishment of its total debt, is income to the respondent in the year the title is acquired to the property, under Section 202 (a), Revenue Act of 1928, *infra*. It is immaterial that the so-called fair market value of the foreclosed properties to

others is less than the price which the taxpayer-mortgagee is willing to pay.

If the fair market value of the property be material, it is quite plain the taxpayer received property of a value equal to the unpaid principal and accrued interest. The property being something of exchangeable value, equivalent to a cash payment, the treatment of the receipt of such property as the receipt of interest is in accordance with this Court's definition of income.

ARGUMENT

PRELIMINARY STATEMENT

Prior to the enactment of the Revenue Act of 1921, c. 136, 42 Stat. 227, life insurance companies were taxable as ordinary corporations and were required to include in gross income not only their investment and underwriting income, but also their gains from the sale of capital assets. When the Revenue Bill of 1918 was before the Senate of the United States for consideration, the Association of Life Insurance Presidents sought and obtained from the Senate an amendment giving to life insurance companies special treatment.[1] The Senate amendment to the House bill, however, was not approved by the House, and life insurance companies, under the Revenue Act of 1918, c. 18,

[1] Hearings before the Senate Committee on Finance, on H. R. 8245, 67th Cong., 1st Sess., p. 84, September 1–October 1, 1921. See also S. Rep. No. 275, 67th Cong., 1st Sess., p. 20.

40 Stat. 1057, were still taxable as ordinary corporations.

Subsequently, however, when the Revenue Bill of 1921 was under consideration, both the life insurance companies and insurance companies other than life or mutual, renewed their efforts, because of the peculiar nature of their business, to obtain a special classification for purposes of Federal taxation, and in this these companies were successful, with the result that since the enactment of the Revenue Act of 1921 the gross income of such insurance companies and the deductions permitted them are substantially different from those of ordinary corporations. Thus, life insurance companies are, by Sections 201 to 203, inclusive, of the Revenue Act of 1928 (reenacting the corresponding provisions of the Revenue Acts of 1921, 1924 and 1926), as well as the corresponding provisions of the Revenue Acts of 1932 and 1934, segregated for tax purposes from other corporations, the gross income of such companies consisting solely of interest, dividends, and rents received during the tax year. "Underwriting income," under the Revenue Acts of 1921 and subsequent Revenue Acts, is not included in the gross income of a life insurance company, nor are gains upon the sale of capital assets recognized. Again, the deductions permitted to life insurance companies under the provisions of Section 203 of the Revenue Act of 1928, as might be expected, differ materially from those allowed ordinary corporations, and the deductions allowed